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CHINA'S AUTO SECTOR

Issues and Background

Chinese and foreign industry experts estimate that China's total vehicle market--cargo and passenger units--will grow by some 10 percent annually through the end of the decade; in 1993 Chinese organizations and individuals owned 1.2 million passenger vehicles--70 percent of which are imports--a number that is expected to grow to reach over three million by the year 2000, according to press reports and a World Bank study. Auto and auto parts imports last year topped $4 billion, according to press reports, up from $2.5 billion in 1992. At the same time, Chinese officials are expecting an even larger surge in demand for motorcycles as per capita income, particularly in booming coastal provinces, rises above $1000 annually.

Concerned that growing imports--exacerbated by rampant smuggling of passenger vehicles--are draining foreign currency reserves, Chinese leaders are seeking to expand domestic production. The President of the China National Automotive Industry Corporation in 1993 proposed a 10-year plan to increase domestic output from the current 1.18 million units to 3 million units and, between 1988 and 1997, China plans to spend nearly $5 billion upgrading and expanding manufacturing facilities; in 1993, China produced 1.31 million vehicles, including 234,000 cars, up 22.8 percent from 1992. Second in the world only to Japan, China's motorcycle output reached 3 million units last year, but industry officials plan to purchase several additional foreign production lines to keep pace with burgeoning demand; China has imported 21 motorcycle assembly and parts production lines since the mid-1980s. Industry press estimates that motorcycle production will reach 5-8 million units annually by 2000.

In a move designed to consolidate and protect China's domestic auto industry, the State Council in April announced a new industrial policy for autos. Under the policy, Beijing will approve no new auto manufacturing and assembly plants through 1995, the end of the current five year plan, and, subsequently, new assembly plants will only gain approval if they can achieve at least 40 percent domestic content at start-up, according to press reports. Under the policy, Beijing plans to consolidate the country's auto production into at most six or seven major auto manufacturing conglomerates, placing previously independent factories under umbrella management organizations to develop economies of scale. Vice Premier Li Lanqing has stated that China's passenger vehicle production lines are too dispersed and inefficient, use only a small proportion of Chinese-made parts, and turn out a low-tech, low quality vehicle. China currently has more than 200 vehicle assembly facilities with 4,000 attendant parts plants as well as 100 motorcycle factories sourcing from 600 parts facilities, but the majority of production takes place at fewer than 100 factories, according to press reports. Following consolidation, Beijing hopes that the remaining conglomerates will produce a total of 5 million vehicles annually, fill 90 percent of China's domestic vehicle demand, and compete internationally.

At the same time, Beijing encourages joint ventures in components production, hoping to boost the domestic content of its vehicles, and a number of US, European, and Japanese companies have already begun contract negotiations for parts plants. Industry press predicts a market for auto parts worth nearly $5.7 billion by the year 2000. Moreover, after 1995, companies already engaged in joint component manufacturing will have an advantage in achieving the 40 percent

localization requirement to establish final assembly lines, and would receive priority from Beijing.

Beijing also recently designated the automotive industry--along with machine building, electronics, petrochemicals, and construction--as a "pillar" industry, which makes factories and research institutes eligible for additional subsidies, low-interest loans, and bond-issuing privileges. Official statements show that Chinese leaders believe that the "crossover" technologies, manufacturing know-how, and advanced management techniques gained through developing pillar industries will improve product quality and competitiveness in other sectors, such as metallurgy and plastics, as well as provide markets for those sectors.

US Angle. There are no signs that Beijing is contemplating a significant reduction in vehicle tariffs or government control over the industry--import taxes were reduced on 1 January 1994, but remain as high as 150 percent--that would expand market opportunities for US and other foreign manufacturers. Statements by officials of the Ministry of Machinery Industry--which oversees the auto industry--indicate that Chinese authorities view the industry as an "infant" that must be protected from foreign competition, even following GATT accession. Indeed, Beijing in July 1993 reversed earlier liberalization of import authority by establishing the China Trade Center For Automobile Import and granting it a monopoly on import licenses.

China is also likely to continue limiting foreign investment in automotive manufacturing. Under the new industrial policy, foreigners are restricted to investing in the manufacture of trucks, motorcycles, or parts and components, according to press reports. Even if the investment restrictions relax somewhat as scheduled after 1995, companies already established in assembly or parts manufacturing ventures will have an advantage in gaining approval for assembly plants; only one of the six most likely contenders to fill the limited slots for auto assembly lines under the new policy is a Sino-US joint venture. Moreover, Beijing is maintaining its import substitution policy of forcing foreign manufacturers over a specified period of time to increase the percentage of locally-produced parts used in finished vehicles, despite continuing problems with quality and on-time delivery from domestic factories.

In addition, the high-cost of private passenger vehicles is likely to slow demand in the foreseeable future. The least expensive locally-produced vehicle--the Charade, produced by a joint venture with Daihatsu--costs the equivalent of $10,574, the Santana--produced under a joint venture arrangement with Volkswagen--runs $18,700, and an imported Toyota Crown costs $46,000-56,500. Meanwhile, a less expensive small car, the Haishen, which will cost as little as $2,900 is currently under development at China's First Autoworks--a joint venture with Volkswagen. Sales have not yet begun.